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Subcommittee on Africa, Global Human Rights and International Operations
Implementing the Microenterprise Results and Accountability Act of 2004

Good afternoon. First, I would like to thank Chairman Smith, for having me here today and for his continued support of microfinance as a development tool. I would also like to thank the members of the committee for allowing me to share my views along with Assistant Administrator Jay Smith. I traveled with Mr. Smith to Ecuador this summer with staff from the Committee and FINCA's Ambassador of Hope, actress Natalie Portman.

It is my personal view that Jay Smith is a development professional with great integrity who is clearly committed to moving microfinance forward inside of USAID. However, change is difficult for all organizations and the perspectives I share with you today are offered in the hope of realizing the potential that microfinance has for achieving US foreign assistance goals.

We are here to discuss accountability, and microfinance is all about accountability. Clients receive loans, not grants and are responsible for their timely repayment.

Since this hearing focuses on the implementation of the Microenterprise Results and Accountability Act of 2004, I would like to speak to two key objectives underpinning the legislation:

- Has USAID implemented the prescriptions in the legislation so that more taxpayer dollars flow into the hands of those institutions that directly provide services to the poor.
- Is USAID leveraging microfinance to open up financial sectors in developing countries so that large numbers of the poor have access to investment capital with which they can break out of poverty?

I would imagine that virtually every person you will hear from today can attest to the power and the potential of microfinance. Historically, microfinance is one of the most effective and proven development vehicles for tapping the business and leadership potential of the poorest members of society and in the process, fostering more equitable and pluralistic societies.

The American people through Congress and their own pocket books via donations to organizations such as FINCA, World Vision, Save the Children and Opportunity International have endorsed microfinance—delivered through direct retail service providers—as a strategy they support to help alleviate poverty.

It is in the best interest of the United States—our people and our government—to:

- Facilitate access to financial services,
- Nurture microenterprise in developing countries; and

- Build inclusive financial sectors.

By supplying these lending opportunities to those in the most need, microfinance helps stop extremism and hatred before they erupt into global conflicts and terrorist activities. Successful microfinance clients have the tools needed to participate in a democratic society and more importantly they have hope for the future, a crucial commodity in any society.

For example, last month I traveled to visit our offices in Afghanistan. There microfinance is not only building a financial sector—in a country where a stable banking environment has been almost non-existent—but building the capacity of both men and particularly women to become active members of a representative society.

In addition to the many microfinance clients who are now teaming into our market offices for loans in places like Herat and Kabul, I also had the opportunity to meet with members of the Afghan cabinet to help illustrate the enormous impact microfinance can have on the financial sector as a whole. I shared with them the example of Uganda and the growth of the microfinance sector there.

Micro loans in Uganda are going to people like Mrs. Efuwa a FINCA client. When I first met her in 2004, she had successfully paid off her first micro loan of $100. Before the loan she was making less than 15 cents a day as a field laborer; her husband less than 75 cents a day in construction. They had eleven children, six of whom were HIV/AIDS orphans. They lived in a small one room house. The only bedding they had was from the clothing of deceased relatives. With her loan, Mrs. Efuwa opened an outdoor cooking stall near a factory. She now makes more than $1 a day and her first priority is to buy beds for the family.

Policy makers often see this type of micro lending as a social safety net. Many are not convinced that clients like Mrs. Efuwa add any value to the economy. Nor do they consider that microfinance organizations that serve clients like Mrs. Efuwa have a transformational impact on the financial sector.

According to recent data, commercial banks in Uganda have more than 200,000 depositors and only 17,000 borrowers. In contrast, microfinance institutions are lending to more than 400,000 clients or 20 times as many borrowers as commercial banks.

To help garner the many financial and social benefits of microfinance, it is also in the best interest of the United States to utilize best-practice implementing organizations—be they for-profit, not-for-profit, local, or international—to ensure the delivery of effective, sustainable foreign assistance over the long term.

USAID's microenterprise program has flourished over the past 20 years and FINCA has flourished with it. In fact, FINCA was built in part through a matching grant from USAID's office of private voluntary cooperation. Also, the growth of one of our most successful affiliates, FINCA Ecuador was financed via a USAID PRIME grant of $600,000 in 1997 from the microenterprise office. Loans dispersed by this affiliate in Ecuador now stand at almost $35 million.

However, that $600,000—a relatively small number when considering foreign aid—received by our Ecuador program in 1997 is more than double that received by the entire FINCA network for FY

2005. In recent years funding garnered through USAID for FINCA programs has greatly diminished:

- For FY2002 FINCA funding from USAID stood at nearly $3.6 million.
- This same number dropped to nearly $2 million in FY2004 and to less than $270,000 ($267,788) in FY2005—an 87 percent decline for the year.
- During the same period, FINCA drew on other funding sources. Our network programs grew 40 percent and loans outstanding have increase from almost $33 million to more than $95 million.

And while funding to providers such as FINCA was on the decline, US funding appropriated by Congress for the Office of Microenterprise Development and microenterprise activities in general has been increased. The fact that FINCA can still survive in spite of decreased government funding illustrates the power of a global institution to leverage funding across a network to sustain stable institutions while it develops capacity in newer ventures.

Much like its clients, FINCA leverages invested capital from commercial sources such as the international responsAbility fund, a socially conscious investment group, to multiply their effect. This process not only garners additional millions in equity, but increases social impact in affiliates across the globe.

The small amounts of USAID funding—particularly crucial funding for loan capital and start-up operations that have been so critical in helping build sustainable microfinance institutions—are drying up. This type of funding is critical to expanding the reach of microfinance services to the estimated 800 million people as yet un-served in the microfinance market.

Given that microenterprise development appropriations are not earmarked, this essential funding often comes from USAID missions. Due to personnel cutbacks, these missions lack staff with technical knowledge of the intricacies of microfinance. They often outsource the formulation and execution of their microfinance strategy to consultants. In the process, the resources that finally get into the hands of the direct service providers are diminished. Moreover, the focus of these consultant-led initiatives tends to be on industry building activities instead of getting resources into direct service provision.

Since the enactment of the law, we have not seen any evidence that this pattern at the missions has changed. Indeed, USAID Azerbaijan had a strategy earlier this year where they planned to focus on direct service providers. The mission then suddenly switched to a consultant-led microfinance industry initiative. I want to note that consultants are essential for the development of microfinance. For instance, DAI has done an excellent job serving in a supporting role to the Microfinance Investment Support Facility for Afghanistan (MISFA*)*. As in a good play, consultants need to be properly cast. USAID now tends to cast them in the leading roles as opposed to the supporting roles and herein lies the mistake.

At the central level, the Office of Microenterprise Development has not formulated a clear vision for implementing the prescribed changes called for in the Act. The Leader with Associates (LWA) mechanism does seek to work through direct service providers. It has been in formulation for more than a year now and has yet to be implemented. It also seems to focus more on industry building activities and not direct service provision. There is little evidence at the missions that staff are knowledgeable about the law governing USAID's microenterprise program.

In the past the Office of Microenterprise Development played to the comparative strengths of all players in the field to yield the best outcomes. There was a strong focus on building strong retail microfinance institutions. This focus seems to have changed to an "industry building" agenda and less on service providers.

Without continued investment in direct service providers, microfinance cannot reach its promise. Just to keep up with the population growth in the Middle East, there will need to be roughly 4 million new jobs created every year for the next 20 years. Can a microfinance strategy that focuses too broadly on enabling environments and technical assistance really be called upon to meet that need? Can an enabling environment help those millions living in poverty in Africa? Can an enabling environment contribute on a broad scale to the empowerment of women in Afghanistan? I would argue that a strategy that encompasses both growth in direct service providers and strong enabling environments positions the US once again as a leading-edge promoter of overall, best practice microfinance.

Because funding goes almost directly to loan recipients, it is one of the most immediate ways to ensure US foreign assistance dollars end up in the hands of those in need in countries around the world—and with great results. Returns on investment for micro loans are enormous, ranging from 100- 300 percent.

But there is much to be done. For every nation like Uganda where micro credit is beginning to show promise, there are others where the seeds have only just been planted.

The opportunity is there for the US and partner organizations to nurture these seeds, so that with respect, responsibility, and accountability – these individuals, these communities and these countries can do more for themselves than we could ever do for them.

In short, I believe through a more strict interpretation of the Microenterprise Results and Accountability Act by the Office of Microenterprise Development a balance can be reached in the funding of all sectors: enabling environments, technical assistance and direct service providers. The US remains a leader in microfinance, but, to maintain this role; it is imperative to fund direct service providers in addition to the policy sector as a whole. It is absolutely essential that we as a nation do not miss the opportunity to truly harness the full potential of microfinance on a global scale—a potential that can only be reached by funding retail services in an effort to build inclusive financial sectors.

Once again thank you for this opportunity. At this time I would be happy to answer questions from the committee.

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